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Installation services inextricably linked to supply of equipment not taxable under the India-Canada tax treaty though can be taxed under the Act

In brief

In a recent decision in the case of Dodsal Pvt. Ltd.[1] (the assessee), the Mumbai Income-tax Appellate Tribunal (the Tribunal) held that where installation and commissioning services are an integral part of the supply of plant and machinery, and such services were ancillary and subsidiary, as well as inextricably and essentially linked to the supply of the plant and machinery by virtue of Article 12(5)(a) of India-Canada double tax avoidance agreement (the tax treaty), the amount paid for such services was not taxable in India in the hands of the non-resident supplier company. Therefore, no tax was required to be withheld under the provisions of section 195(1) of the Act and hence, no disallowance under section 40(a)(i) of the Act was called for.

Facts

- The assessee is a company engaged in the business of engineering and general contracting.
- The company had entered into two separate contracts for purchase, installation and commissioning of the supervisory control and data acquisition (SCADA) system and application computer programmes in object code/binary

[1] DCIT *v.* Dodsal Pvt. Ltd. [TS-675-ITAT-2012(Mum)]

format for the CCKPL project. Both the contracts were issued under one letter of intent.

- The assessee had offered for disallowance amount paid towards installation charges in relation to the supply of plant and machinery under section 40(a)(i) of the Act as no tax was withhold. It later filed a revised return claiming the amount on the grounds that it was not taxable in India in terms of Explanation 2 to section 9(1)(vii) of the Act.

- The assessing officer (AO) disallowed the claim made by the assessee under section 40(a)(i) of the Income-tax Act, 1961 (the Act).

Issue

Whether the consideration paid by the assessee to the non-resident company for installation and commissioning charges is covered by the exception provided in Explanation 2 to section 9(1)(vii) of the Act and/or under Article 12(5)(a) of the tax treaty

Assessee's contentions

- Payment towards installation, application and commissioning of plant and machinery was part and parcel of the purchase consideration and could not be severed. Accordingly, the two agreements could not be read in isolation of each other.

- Installation charges paid were in relation to the plant and machinery supplied by the non-resident company, and the amount was not taxable in India as per Explanation 2 to section 9(1)(vii) of the Act.

- As per Article 12(5)(a) of the tax treaty, fees for included services does not include the amount paid for services that are ancillary and subsidiary as well as inextricably and essentially linked to the supply of equipment.

- The SCADA system is a complex object code/binary format which can be installed and commissioned only by the professional support of the non-resident company.

- The assessee relied on the judgement of the High Court (HC) in the case of Orissa Synthetics Ltd.[2] and Sundwiger EMFG & Co.[3].

Revenue's contentions

- The assessee has entered into two separate contracts with the non-resident company, one for the supply of equipment and another for installation and commissioning work. Both contracts were different and not interlinked.

- The contract for supply of equipment did not bind the non-resident company to provide the services in relation to installation and commissioning work.

- The amount paid towards the erection and commissioning of the plant and machinery was not covered in the exception provided either in Explanation 2 to section 9(1)(vii) of the Act or by Article 12(5)(a) of the tax treaty.

Tribunal ruling

- The scope of work of the non-resident company included software development, project management, system design, system engineering and integration, training, supervision of installation and assistance in commissioning of the SCADA system. These services cannot be regarded as consideration for any construction, assembly, mining or similar project as under Explanation 2 to section 9(1)(vii) of the Act.

[2] Orissa Synthetics Ltd. *v.* ITO [1993] 203 ITR 34 (Orissa)
[3] CIT *v.* Sundwiger EMFG & Co. [2003] 262 ITR 110 (AP)

- The Tribunal relied on the decision in the case of Hotel Scopevista Ltd.[4] wherein it was held that 'consideration for construction project' within the meaning of Explanation 2 to section 9(1)(vii) of the Act means consideration for actual construction activities undertaken in India and not the consideration for any services in connection with the construction project. Thus, installation and commissioning would be taxable in terms of Explanation 2 to section 9(i)(vii) of the Act.

- By virtue of Article 12(5)(a) of the tax treaty, installation and commissioning services rendered by the non-resident company were ancillary and subsidiary as well as inextricably and essentially linked to the supply/sale of the plant and machinery. Thus, the amount paid for the said services by the assessee company was not taxable in India.

- On the basis of the tax treaty, the assessee was not liable to withhold tax from the payment made towards installation and commissioning work to the non-resident company and the disallowance made under section 40(a)(i) of the Act was not sustainable.

Conclusion

Although separate and distinct contracts have been entered into for the supply and installation of plant and machinery, such installation and commissioning work would not be taxable in India as they were covered by the exclusionary clause of the India-Canada tax treaty.

It may be noted that any services rendered in India in connection with construction, mining, assembly or similar project would be taxable in India in terms of Explanation 2 to section 9(i)(vii) of the Act unless exempted by the exclusionary clause of the applicable tax treaty.

[4] **Hotel Scopevista Ltd. *v.* ACIT [2007] 18 SOT 183 (Delhi)**

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